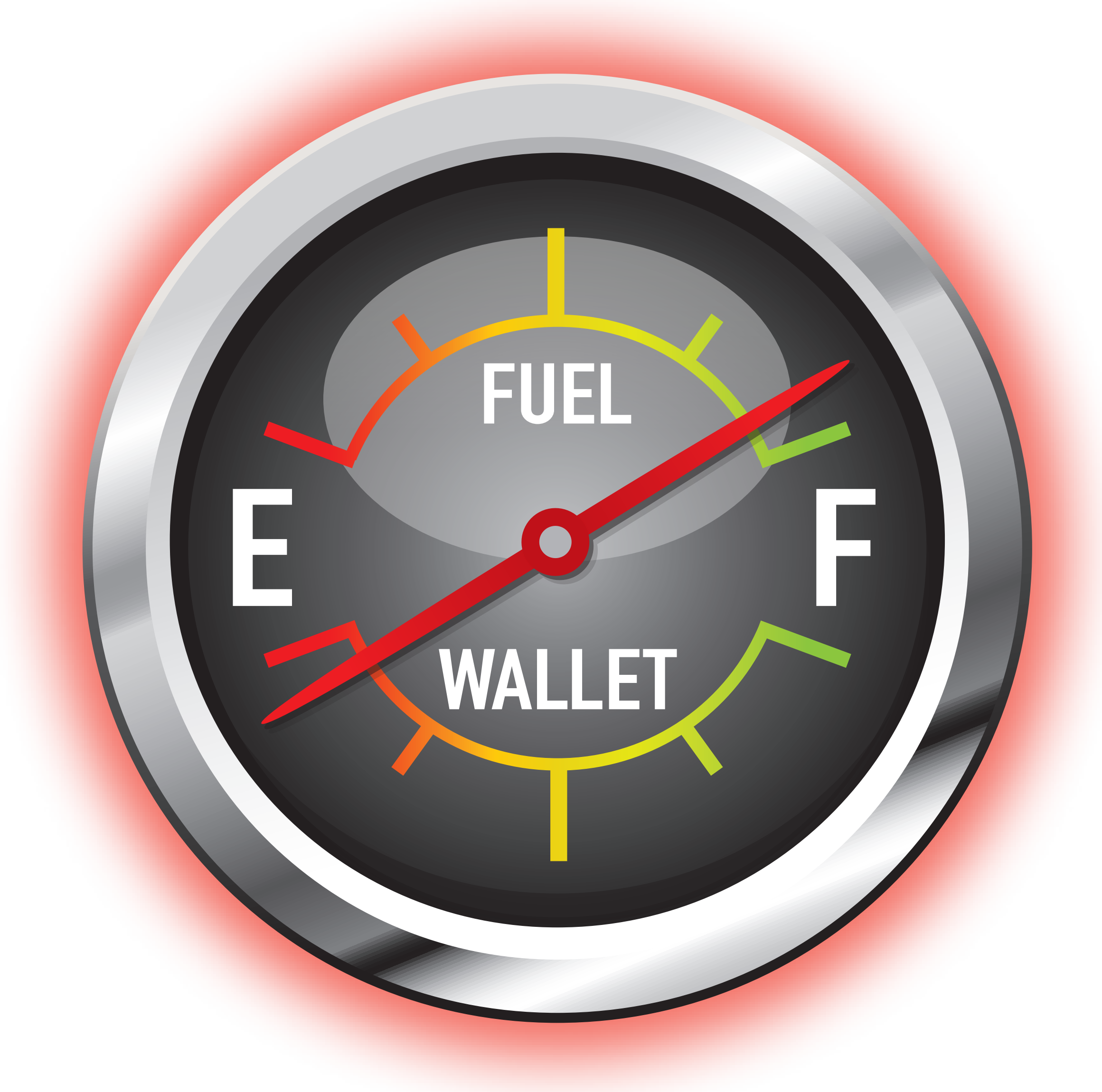

Pain Beyond the Pump

High Oil prices Impacting the Economy, Housing, and the Fed

By Bill Bodnar
Tabrasa LLC

"Pain at the pump" isn't a new concept for American consumers, but it's curently what the U.S. economy is dealing with as oil remains above $100 a barrel for the first time in seven years. Let's look at what high energy prices are doing to the broader economy and housing as the pain begins to stretch beyond the pump.

PERSONAL SAVING RATE (PSAVERT)

THE TALE OF TWO INFLATIONS

You don't have to go far to hear people talking about how inflation is soaring. It is important to remember when the business channels and media outlets talk about inflation there are two types — headline inflation, which includes energy and food costs, and core inflation, which excludes food and energy.

Consumers can't avoid headline or energy-related costs. We all must drive, heat our homes, and eat (although some of us would like to eat less). Diesel prices have also been moving sharply higher, and it's a major input cost in food due to the transportation and distribution needs. Whether it's the mills, plants, tractors, or shipping, higher diesel costs run throughout the food supply chain.

Both higher energy costs and headline inflation are making an impact on consumers and corporations. Best Buy, Target, and Wal-Mart all reported shrinking margins due to higher energy and shipping costs, but also lower sales of larger items like televisions and exercise equipment since people are spending so much on daily essentials that they pass on other items.

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PERSONAL SAVINGS RATE DECLINING FAST

Look at the right side of the chart above from the St. Louis Federal Reserve. The Personal Savings Rate is falling fast, which means consumers are dipping into savings to help pay the higher costs for everything, including energy and daily essentials. Why is this a concern? Consumer Spending makes up nearly two-thirds of our Gross Domestic Product (GDP). If the consumer retreats, we could see the U.S. slip into a recession, defined as two consecutive quarters of negative growth. With the first quarter GDP contracting by 1.5%, we will be close to a "textbook" recession within the 1st half of 2022.

NEW SINGLE-FAMILY HOMES

April new home sales highlighted the additional costs, due in part to higher energy prices, required to build a home. In all, 591,000 units were sold, representing a 27% decline from April 2021. Moreover, the 444,000 new homes available for sale represent a 9-month supply at the current sales pace.

The median home price was $450,600, which is pricing a lot of borrowers out of the market. Expect new single-family home construction and sales to remain under pressure as higher oil and diesel prices, coupled with supply chain and labor issues, make new single-family homes too expensive for a borrower dealing with record gas prices and higher mortgage rates, let alone a 25% decline in stocks through May.

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The good news? If home prices remain stable and even decline modestly, it would be healthy for a housing market that was experiencing unsustainable home price gains from 2020 until now.

THE FED'S ROLE IS LIMITED

In the mortgage industry, we've already endured a material increase in mortgage rates as the Fed "jawboned" the financial markets with tough, hawkish rhetoric since November 2021. But can the Fed follow through

OIL /BARREL RATES 2001-2022

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with the expectations they set of multiple rate hikes and shrinking of their balance sheet, and will it help lower oil prices?

Fed rate hikes will not lower oil prices — unless they overdo the hikes and slip the U.S. economy into a recession — which is a distinct threat. Back in 2014 to 2015, oil prices declined sharply due in part to recession fears, but also because our domestic production was soaring, and we had a calmer geopolitical environment, today things are quite the opposite.

Look at the Oil/Barrel Rates chart above. We are in uncharted waters. The shaded areas show oil prices above $100 in the last 20 years. The Federal Reserve has NEVER hiked rates when oil traded above $100. Until now.

HIGH OIL DOING FED'S JOB

The additional cost of daily essentials, thanks to those higher oil prices, is doing the job of the Fed. It's slowing demand to get more in balance with supply. It appears the Federal Reserve is acknowledging how fast consumer sentiment and behavior are changing in response to high oil prices. Fed President Raphael Bostic recently suggested .50% rate hikes in June and July and then a pause. St. Louis Fed President James Bullard, who has been the most hawkish of the Fed members, is now saying a .50% hike seems like a "good plan".

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THE BOTTOM LINE

Higher energy costs are an economic threat that the Federal Reserve can't fix with higher rates or selling bonds from its balance sheet. Let's hope we experience some relief in energy prices, which would also provide much needed relief in food inflation. In the absence of some sustainable relief, costs could impact housing as the inability to save and lack of confidence to take on new debt could slow demand further.

There is good news. The U.S. Bond market, which the Fed can't control, has already shown signs of rate peaks. The 10-year note recently hit a peak of 3.20%, that is keeping a 40-year trend of the 10-year yield making lower lows and lows highs intact. For now.

Couple stable rates with a tight labor market and we should see housing thrive in the second half of 2022.


Bill Bodnar

Bill Bodnar is currently Chief Revenue Officer of Tabrasa LLC, as well as Chief Market Analyst for the Mortgage Market Guide, a market intelligence solution being used by thousands of mortgage lending officers across the country every day. He is also a partner of The Bourbon Room, an '80s themed nightclub, in Hollywood, California.